

Franchise Tax Board**ANALYSIS OF ORIGINAL BILL**

Author: Strickland Analyst: William Koch Bill Number: SB 463
Related Bills: See Legislative History Telephone: 845-4372 Introduced Date: February 26, 2009
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Renewable Energy Resource Project Or Renewable Energy Resource Conversion
Technology Project Credit

SUMMARY

This bill would allow a tax credit of up to \$3,000 for the purchase and installation of a renewable energy resource project or a renewable energy resource conversion technology project, as specified.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to reduce electricity usage from the energy grid.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2009, and before January 1, 2017.

POSITION

Pending.

ANALYSISFEDERAL/STATE LAW

Existing federal and state laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Federal law currently provides a renewable electricity production credit and an energy credit. The renewable electricity production credit is part of the general business credit. The energy credit is a component of the investment credit, which is also part of the general business credit.

Board Position:

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<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Selvi Stanislaus

05/07/09

The federal renewable electricity production credit is allowed for the production of electricity from qualified energy resources at qualified facilities. Qualified energy resources include wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, and qualified hydropower production. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person. The credit, in general, is 1.5 cents per kilowatt-hour (indexed annually for inflation) of electricity produced. The amount of the credit is 2.1 cents per kilowatt-hour for 2008.

The federal energy credit is allowed as a percentage of the cost of new property that is equipment that either (1) uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) is used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage. Property used to generate energy for the purposes of heating a swimming pool is not eligible solar energy property. The credit, in general, is 30 percent of the cost of property that uses solar energy and 10 percent of the cost of property that uses geothermal energy.

Existing **state law** has no comparable credits¹.

Under state law, for taxable years beginning on or after January 1, 2008, and before January 1, 2010, the total of all business credits otherwise allowable may not exceed 50 percent of the net tax of the taxpayer for that taxable year. Taxpayers with net business income of less than \$500,000 are excluded from this limitation.

In addition, current state Corporation Tax Law allows the assignment of certain credits to taxpayers that are members of a combined reporting group and adds the following provisions:

- Provides that an “eligible credit” may be assigned by a taxpayer to an “eligible assignee.”
 - “Eligible credit” means any credit earned by a taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, which is eligible to be carried forward to the taxpayer’s first taxable year beginning on or after July 1, 2008.
 - “Eligible assignee” means any “affiliated corporation” that is a member of a combined reporting group at certain specified times.
 - “Affiliated corporation” means a corporation that is a member of a combined reporting group.
- Provides that the election to assign any credit is irrevocable once made and is required to be made on the taxpayer’s original return for the taxable year in which the assignment is made.

¹ For taxable years beginning on or after January 1, 2001, and before December 1, 2006, prior state law provided a tax credit for taxpayers who purchased a solar or wind energy system for installation and electrical generation in California.

THIS BILL

Under Personal Income Tax Law and Corporation Tax Law, this bill would allow a credit equal to 30 percent of the costs paid or incurred by the taxpayer during the taxable year for the purchase and installation of a renewable energy resource project or a renewable energy resource conversion technology project. This bill would require either type of project to be installed on property owned or leased by the taxpayer and reduce the taxpayer's energy usage from the energy grid.

This bill would do the following:

- Apply to taxable years beginning on or after January 1, 2009, and before January 1, 2017.
- Limit the credit to a maximum amount of \$3,000 per taxpayer for all taxable years.
- Allow a taxpayer to carry over unused credits over indefinitely, until exhausted.
- Remain in effect until December 1, 2017, and as of that date be repealed.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill would provide a credit for the purchase and installation of a renewable energy resource project or a renewable energy resource conversion technology project that reduces the taxpayer's energy usage from the energy grid. This bill lacks a definition or explanation of what would qualify as a renewable energy resource project or energy resource conversion technology project. This bill also lacks a definition of energy grid. Undefined terms can lead to disputes between taxpayers and the department. The author may wish to amend this bill to provide additional clarity and guidance.

This bill would require that the renewable energy resource project or the renewable energy resource conversion technology project reduce the taxpayer's energy usage from the energy grid. The department lacks expertise to determine if the renewable energy resource project or the renewable energy resource conversion technology project reduces a taxpayer's energy usage from the energy grid. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. The author may wish to amend this bill to require certification that the renewable energy resource project or the renewable energy resource conversion technology project reduces a taxpayer's energy usage from the energy grid.

LEGISLATIVE HISTORY

AB 811 (Levine, 2007/2008) would have allowed a credit for an unspecified percentage of the cost to construct an eligible renewable resource. The renewable resource credit provisions were amended out of AB 811.

AB 2567 (Arambula, 2005/2006) would have allowed a 20 percent research expense credit for specified research activities related to the development of renewable technologies. AB 2567 was held in the Assembly Appropriations Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida law provides the following two energy related credits:

- The renewable energy technologies investment tax credit is equal to 75 percent of capital, maintenance, and research and development costs. The costs must be incurred between January 1, 2006, and June 30, 2010.
- The renewable energy production credit is for new or expanded renewable energy facilities and is equal to \$.01 per kilowatt-hour of electricity produced. For new facilities, the credit is based on the entire amount of electricity produced, and for expanded facilities, the credit is based on the increases in the facility's electrical production achieved after May 1, 2006.

Michigan allows an income tax credit that is similar to California's research credit. The credit is for qualified businesses located within an alternative energy renaissance zone that are engaged solely in the research, development, or manufacturing of an alternative energy technology, including renewable energy.

Illinois, Massachusetts, Minnesota, and New York do not have a similar credit.

FISCAL IMPACT

If the bill is amended to resolve the implementation considerations addressed in this analysis, the department's costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

Based on the data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact for SB 463 As Introduced February 26, 2009, Effective for Taxable Years BOA 1/1/09 [\$ In Millions]		
2009-2010	2010-2011	2011-2012
-\$10	-\$16	-\$15

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this bill depends on the amount of costs incurred for renewable energy resource projects or renewable energy resource conversion technology projects, tax credits generated and the amount of credits applied to reduce tax liabilities.

Available information indicates that during the period from 1998 through 2006, the California Energy Commission's Emerging Renewables Program (ERP) and California Public Utilities Commission's Self Generation Incentive Program (SGIP) rebates encouraged similar renewable energy projects as proposed in this bill. Rebates were available to both residential and business purchasers of solar, wind, fuel cell, biogas and combined heat and power systems that connected to the California energy grid and generated electricity to offset the purchaser's on-site electrical load. The ERP limited eligible fuel cell systems to less than 30 kilowatts in size and limited wind systems to not larger than 50 kilowatts in size. The SGIP was available for systems larger than 30 kilowatts. Both the ERP and the SGIP were predecessors to the current California Solar Initiative.

Statistics from the ERP indicate that 17,510 rebate claims totaling approximately \$745 million in project costs were approved from January 2003 through May 2008, resulting in an average of 3,891 claims approved per year $[17,510 \text{ claims} / 4.5 \text{ years} = 3,891 \text{ claims per year}]$. Costs of individual projects ranged from \$1,000 to over \$1 million with 3.4 percent (602/17,510) of projects costing less than \$10,000. If a similar number of projects qualify for the credit proposed by this bill, the average credit amount would be approximately \$2,900 $[96.6\% (100\% - 3.4\%) \times \$3,000 \text{ maximum credit } (30\% \times \$10,000) \approx \$2,900]$.

For purposes of this estimate, it is assumed that the number of smaller projects (comparable to ERP-eligible projects) that would claim this credit in 2009 would approximate the average number of rebates per year approved for the ERP from 2003 through mid-2008. For 2009, it is estimated that 3,900 smaller projects would claim the average credit amount of \$2,900, resulting in approximately \$11,300,000 of credits generated $[\$2,900 \times 3,900 \approx \$11,300,000]$.

Statistics from the SGIP indicate that 1,554 larger projects were completed and active from 2001 through 2007, resulting in an average of 222 complete and active projects per year $[1,554 \text{ projects} / 7 \text{ years} = 222 \text{ projects per year}]$. For purposes of this estimate, it is assumed that the number of larger projects that would claim this credit in 2009 would be approximately the average number of projects completed and active per year for the SGIP. For 2009, it is estimated that 220 larger projects would claim the maximum \$3,000 credit, resulting in \$660,000 of credits generated $[\$3,000 \times 220 = \$660,000]$.

The ERP rebate program was limited to renewable energy projects installed within California; however, this bill does not limit the credit to costs for projects installed in California. To account for apportioning corporations claiming the credit for projects located outside of California, the amount of potential credits claimed in 2009 is increased by an additional 25 percent, resulting in an additional \$2,992,500 of credits generated $[\$11,310,000 + \$660,000 \approx \$11,970,000, \$11,970,000 \times 25\% = \$2,992,500]$.

For 2009, total credits generated is \$14,962,500 [$\$11,300,000 + \$660,000 + \$2,992,500 = \$14,962,500$]. It is anticipated that 20 percent of taxpayers entitled to the credit would not report the credit in the initial tax year that the credit is available and that this percentage would decrease to 5 percent by 2011. In addition, it is estimated that 50 percent of credits generated would be applied in 2009 resulting in revenue losses of \$6 million for 2009 [$\$14,962,500 \times 80\% \approx \11.9 million, $\$11.9$ million $\times 50\% \approx \$6$ million].

Tax year estimates are converted to cash flow fiscal year estimates reflected in the table. For example, the 2009-2010 cash flow estimate includes \$6 million in reduced tax liability for 2009 and approximately \$4 million in reduced estimated payments for 2010.

ARGUMENTS/POLICY CONCERNS

Conflicting tax policies come into play whenever a credit is provided for an item that could be deductible as a business expense or is otherwise reflected as an adjustment to the basis of property for tax purposes. Providing both a credit and allowing the full amount to be deducted (or added to basis) would have the effect of providing a double benefit for that item or cost. On the other hand, making an adjustment to deny the deduction or reduce basis in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general federal conformity policy.

Additionally, the credit would be allowed for the purchase and installation of a renewable energy resource project or renewable energy resource conversion technology project whether installed inside or outside of California.

This bill lacks a requirement for a taxpayer to use the renewable energy resource project or a renewable energy resource conversion technology project for a specified duration. It is possible that a taxpayer could use the renewable energy resource project or a renewable energy resource conversion technology equipment briefly, claim the credit, and then resell the equipment to a third party that may also claim the credit. If this bill were to require that the equipment be placed in service in California, with an appropriate recapture provision to ensure continued operation in California for a specified (recapture) period, this potential problem would be avoided. The recapture provision would require the taxpayer to use the equipment for a certain length of time in this state or add all or some portion of the credit amount back to the tax liability.

This bill would also allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

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